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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 659
No. 660

MOLONEY ELECTRIC COMPANY, *Petitioner,*

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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Your petitioner, Moloney Electric Company, prays that writs of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit in cases No. 11,913 and No. 11,921, consolidated and decided June 9, 1941, rehearing denied June 27, 1941. The Eighth Circuit in part affirmed the United States Board of Tax Appeals and in part reversed the Board.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 15) is reported in 42 BTA 78. The dissenting opinion pertinent to

this petition (R. 29) is reported in 42 BTA at page 88. The opinion of the Circuit Court of Appeals (R. 106) is reported in 120 Fed. (2d) 617.

Jurisdiction.

The jurisdiction of this Court is invoked under the provisions of Section 1141 of the Internal Revenue Code, and Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

1. Does the second sentence of Section 26(c), paragraph (2) of the Revenue Act of 1936, providing that

> "For the purposes of this paragraph a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits."

sufficiently broaden the phrase "within the taxable year" contained in the first sentence of said paragraph to embrace within its scope a contract requiring the setting aside of 20 per cent of the earnings in excess of $320,000, such earnings to be determined from an audit but in no event later than the first of April of the succeeding year, for the reason that a percentage of the earnings cannot be determined until the earnings are determined, and the earnings cannot be determined until the taxable year has elapsed;—or, can the said second sentence be given its full legal effect without having the payment or setting aside take place after the taxable year has closed?

2. Does a contract which expressly deals with the disposition of earnings and profits of the taxable year, but requires the payment of a sum equal to 2 per cent of the debt irrespective of earnings and profits fail to satisfy the requirements of Section 26(c)(2) of the Revenue Act of 1936 because such partial payment of the debt is payable in any

event, or does the said section require that the payment of the debt be solely dependent on earnings and profits?

Statute Involved.

Revenue Act of 1936 (49 Stat. 1664).

"Sec. 26. Credits of Corporations.

"In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

"(c) Contracts Restricting Payment of Dividends.

* * * * *

"(2) Disposition of Profits of Taxable Year.—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word 'debt' does not include a debt incurred after April 30, 1936.

* * * * * "

Statement.

These causes arise in the determination of petitioner's income tax liability for the year 1936.

In the petition before the Board of Tax Appeals for a redetermination of the Commissioner of Internal Revenue's proposed deficiency, your petitioner claimed that in computing the surtax on undistributed profits imposed by the Revenue Act of 1936 it was entitled to the following credits under Section 26(c)(2):

(1) $13,810.00 representing 2% on the largest amount of bonds outstanding during the year; and

(2) $31,526.66 representing 20% of the earnings in excess of $320,000.

The Board sustained your petitioner on the first point, (R. 27-29) and decided against your petition on the second point, (R. 25-27), although there were three dissents thereto, (R. 29).

The Commissioner of Internal Revenue appealed the first point to the Eighth Circuit (No. 11,913) and the taxpayer appealed the second point (No. 11,921). Both appeals were consolidated and the Eighth Circuit decided both points for the Commissioner, (R. 106), (120 Fed. (2d) 617). Rehearing was denied on June 27, 1941 (R. 115).

On July 1, 1928 the taxpayer issued bonds due June 1, 1943 in the aggregate principal amount of $1,500,000 (R. 106). The trust indenture entered into in connection with the issuance of these bonds contained an article (Art. III, Sec. 1) expressly dealing with the disposition of earnings and profits (R. 68) and required the taxpayer to pay to the trustee on June 1, 1936 "a sum equal to 2% of the largest amount of debenture bonds at any time outstanding." The taxpayer was also required to set aside not later than the first of April, and pay to the trustee not later than June 1st, 20 per cent of the earnings for the next preceding year, of the Company in excess of $320,000 (R. 68-69).

Bonds in the aggregate principal amount of $690,500 were outstanding at the beginning of the taxable year 1936. (R. 22). They were all retired during that year. (R. 22). Two hundred and forty thousand dollars of its earnings for 1936 was used in liquidating its bonded indebtedness. (R. 28).

The Board of Tax Appeals in deciding the issues held that Article III of the indenture "does expressly deal with the disposition of earnings and profits of the taxable year" and allowed credit for 2 per cent of $690,500, or $13,810, (R. 29), but held that the 20 per cent of the earnings in excess of

$320,000 provision dealt with earnings of the preceding year rather than with those of the current year (R. 26).

The Eighth Circuit reversed the Board on the 2 per cent point, holding that "A contract which requires a payment irrespective of earnings and profits cannot be said to deal expressly with the disposition of earnings and profits of the taxable year.", (R. 109); and sustained the Board on the second point, (R. 111-112) but a reading of the opinion discloses that the Court gave no consideration to the effect the second sentence of Section 26(c)(2) of the Revenue Act of 1936 has on the phrase "within the year", as is indicated by the partial quotation in the opinion (R. 108). It is self-evident that a percentage of earnings cannot be determined until the earnings are determined, and the earnings cannot be determined until the taxable year has closed.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

(1) In holding that the contract dealt with earnings of the preceding year, instead of the current year, disregarding the fact that earnings on a percentage basis can only be determined after the taxable year has closed.

(2) In failing to give effect to the second sentence of Section 26(c)(2), which expressly covers and includes contracts based on a percentage of earnings and profits.

(3) In sustaining the Board of Tax Appeals on the issue of a percentage of earnings.

(4) In holding that a contract which requires a payment irrespective of earnings and profits cannot be said to deal expressly with the disposition of earnings and profits of the taxable year, thereby failing to recognize that to be a debt it must be payable in any event.

(5) In failing to hold that the 2 per cent payment was a payment under a contract which "expressly deals with the disposition of earnings and profits of the taxable year."

(6) In failing to sustain the Board of Tax Appeals on the 2 per cent issue.

Reasons for Granting the Writs.

These cases present an important question of Federal law which has not been, but should be, settled by this Court.

There are four cases now pending in the Sixth Circuit, all of which involve the application of the second sentence of Section 26(c)(2) of the Revenue Act of 1936, and unless certiorari is granted your petitioner may suffer irreparable injury should the Sixth Circuit reverse the Board, thereby creating a conflict between the Sixth and Eighth Circuits. The cases there pending are:

Strong Manufacturing Co., (41 BTA 1273);
Warren Tool Co., (Memo BTA June 17, 1940);
Ohio Leather Co., (Memo BTA June 13, 1940);
Michigan Silica Co., (41 BTA 511).

All are appealed by the Commissioner of Internal Revenue.

The Circuit Court of Appeals entirely disregarded the most pertinent part of the law in deciding the issue regarding the percentage of earnings. The decision not only contains no discussion of the second sentence of Section 26(c)(2), but its entire disregard of said sentence is indicated by the quotation of the Act (R. 108) which stops just short of the said second sentence.

In deciding the 2 per cent point the Court of Appeals entirely overlooked the fact that to be a debt it must be payable in any event; otherwise, the interest would be that of a partner or stockholder; and credits under Section 26(c)(2) can only be granted if they relate to a discharge of a debt.

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition should be granted, commanding the Circuit Court of Appeals for the Eighth Circuit to certify and send to this Court full and complete transcripts of the rec-

ord and all proceedings in the cases entitled and numbered on its docket, *Guy T. Helvering, Commissioner of Internal Revenue* v. *Moloney Electric Company,* No. 11,913; and *Moloney Electric Company* v. *Guy T. Helvering, Commissioner of Internal Revenue,* No. 11,921 to the end that the said cases may be reviewed and determined by this Court as provided by law, and that petitioner may have such action and further relief in the premises as to this Court may seem proper.

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Attorney for Petitioner.

Of Counsel:
CARL J. BATTER,

September 26, 1941.